

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
DONALD D. AND ANN M. DUFF-Y }

Appearances:

For Appellants: Donald D. Duffy, in pro. per,

For Respondent: Richard C. Creeggan
Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Donald D. and Ann M. Duffy to proposed assessments of additional personal income tax against them separately in the amount of \$57.18 each for the year 1967 and to a proposed assessment of additional personal income tax against them jointly in the amount of \$693.10 plus penalty in the amount of \$103.97 for the year 1968.

From 1950 until February 26, 1959, appellant Donald D. Duffy was associated with California Air Charter, Inc. (CAC). The last four years he was the president.

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Appellants were the only stockholders. CAC was a Tennessee corporation qualified to do business in California. The corporation was authorized to operate as a supplemental air carrier by the Civil Aeronautics Board (CAB). Its principal office and place of business was located at Burbank..

In 1958 the CAB instituted proceedings against CAC to revoke the corporation's operating authority for violation of board economic regulations . On January 2, 1959, the corporation's rights, powers, and privileges were suspended by the State of California for the nonpayment of franchise tax. With the hope that the CAB would reconsider its action if there was a change in corporate management, Mr. Duffy resigned as president and relinquished control of the corporation on February 26, 1959. As part of the arrangement of February 26, CAC issued two notes to appellant, one in the amount of \$16,899 and the other in the amount of \$20,000. The notes reflected debts owed to appellants by the corporation and were incurred as a result of obtaining certification of a leased aircraft and other operating expenses. Notwithstanding the change in management the CAB revoked CAC's interim operating authorization as a supplemental air carrier effective December 2, 1959. (California Air Charter, Inc., 30 C.A.B. 17.) On December 10, 1959, CAC discontinued air carrier operations because of financial difficulties.

CAC's new president attempted to have the CAB reinstate the corporation as a supplemental air carrier. These efforts were conducted at his own expense since CAC had no funds. However, they were to no avail and all applications for reinstatement were dismissed by CAB order E-21241 dated September 3, 1964.

Appellants filed amended returns for 1964, 1965, and 1966. On their 1964 return they claimed a \$36,899 short term capital loss resulting from the CAC notes allegedly becoming worthless in that year. On their 1965 and 1966 returns they carried forward the unused portion of the loss. As a result of the reduced tax liability reflected by the amended returns, appellants filed claims for refund for those years. Respondent denied the 1964 claim on the basis that the debt became worthless prior to January 1, 1961. The 1965 and 1966 claims were denied on the basis that the carryover of the bad debt loss was not permitted by section 17207 of the Revenue and Taxation

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Code prior to its amendment in 1961. Appellants filed separate returns for 1967 and a joint return for 1968, the years in question, and continued to carry forward the unused portions of the CAC bad debt loss. The loss carryovers were again disallowed by respondent for the same reason. Respondent also assessed a late filing penalty because the 1968 return was not filed until July 5, 1969.

The issue for determination in this appeal is whether the nonbusiness bad debt became worthless after January 1, 1961, and is, therefore, subject to treatment as a short term capital loss, or, whether it became worthless prior to January 1, 1961, and must be deducted in total the year it became worthless.

Prior to its revision in 1961, section 17207 of the Revenue and Taxation Code simply provided for a deduction of debts which became worthless within the taxable year. In 1961 that section was substantially revised. Section 17207, subdivision (d)(1)(B), of the Revenue and Taxation Code now provides that a nonbusiness bad debt which becomes worthless in a taxable year will be treated as a short term capital loss, and may be carried over for the next five succeeding years, subject to the limitations contained in sections 18151 and 18152 of the Revenue and Taxation Code. However, 'section 17207, subdivision (d)(1)(B), is only applicable to nonbusiness bad debts sustained in taxable years beginning on or after January 1, 1961, (See Appeal of Jorge and Elena de Quesada, Cal. St. Bd. of Equal., Feb. 5, 1968.)'

In order to claim a deduction for a bad debt within the meaning of section 17207 of the Revenue and Taxation Code the taxpayer has the burden of proving that the debt became worthless in the year for which it is claimed. (Redman . Commissioner, 155 F.2d 319.) The standard for the determination of worthlessness is an objective test of actual worthlessness. The time of actual worthlessness must be fixed by identifiable events which form a reasonable basis for abandoning any hope of future recovery. (Appeal of Kuhn Enterprises, Inc., Cal. St. Bd. of Equal., Aug. 3, 1965; Appeals of Morlyn L. and Velma K. Brown, Cal. St. Ed. of Equal., Oct. 27, 1964.)

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The taxpayer may not postpone a bad debt deduction merely on the hope of future collection. (United States v. White Dental Mfg. Co., 274 U.S. 398 [71 L. Ed. 1120]; Denver & Rio Grande Western Railroad Co. v. Commissioner, 279 F.2d 368, 374.)

With these principals in mind we turn to the facts. In 1958, the CAB instituted proceedings to revoke CAC's operating authority. On January 2, 1959, CAC's corporate powers were forfeited for nonpayment of franchise tax. Mr. Duffy relinquished control of the corporation on February 26. Finally, the CAB revoked the corporation's authority to operate as a supplemental air carrier. Eight days later the corporation ceased business operations because of financial difficulties. In view of the bleak outlook portrayed by these events, and without more, resuondent was unquestionably justified in concluding that the debts became worthless sometime prior to 1961.

However, appellants point out that the corporation's new president continued the efforts to have the CAB reinstate the corporation. It was hoped that with CAB acknowledgment and permanent certification, adequate financing and profitable operations would follow. Subsequently, CAC was made a party to a CAB proceeding known as the "Supplemental Air Service Proceeding, Docket No. 13795." Ultimately, however, all applications by CAC were dismissed as of September 3, 1964. Appellants conclude that the debts did not become worthless until 1964 when the corporation's applications for certification were finally dismissed.

No doubt appellants, in good faith, believed or at least hoped, that with CAB certification CAC could make a financial comeback and eventually repay the debt. However, a subjective hope or belief is not a sufficient basis upon which to predicate a bad debt deduction. (United States v. White Dental Mfg. Co., supra; Denver & Rio Grande Western Railroad Co. v. Commissioner, supra.) When viewed from an objective standard it must be concluded that the debt became worthless prior to January 1, 1961, and not during 1964. This conclusion is emphasized when the nature of the CAB "Supplemental Air Service Proceeding" is considered. This proceeding did not directly concern CAC's operating authority; rather, it was concerned with numerous supplemental air carriers and their place in the future of aviation. (See, e.g., Pan American World Airways, Inc. v. Civil Aeronautics Board, 380 F.2d 770; Great Lakes Airlines, Inc. v. Civil Aeronautics Board, 294 F.2d 217, 221 n. 6, cert. denied, 366 U.S. 965 [6 L. Ed. 2d 1256].) The issue of CAC's certification was, at

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best, peripheral. Appellants have failed to produce evidence that the pendency of this proceeding created more than a glimmer of hope that CAC would ever be able to reinstitute air operations, regain its financial strength, and eventually repay the obligations in question.

When the record is viewed in its entirety, it must be concluded that the debts became worthless at sometime prior to January 1, 1961, and should have been deducted in total the year that they became worthless.

Appellants '1968 return was due April 15, 1969. It was filed July 5, 1969. Section 18681 of the Revenue and Taxation Code provides for a late filing penalty equal to five percent of the tax for each month or fraction thereof that the return is overdue. Respondent applied a 15 percent penalty. Appellant, although challenging the propriety of the penalty has offered no evidence in mitigation thereof. Accordingly, it must be concluded that the penalty was properly assessed.

In line with the facts and conclusions set forth above we find that respondent's determination in this matter must be sustained.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND'DECREED,
pursuant to section 18595 of the Revenue and Taxation
Code, that the action of the Franchise Tax Board on the
protest of Donald D. and Ann M. Duffy to proposed assess-
ments of additional personal income tax against them
separately in the amount or' \$57.18 each for the year
1967 and to a proposed assessment of additional personal
income tax- against them jointly in the amount of \$693.10
plus penalty in the amount of \$103.97 for the year 1968,
be and the same is hereby sustained.

William K. Bessett, Chairman
John W. Fisher, Member
Geoffrey R. R. R., Member
John R. R., Member
_____, Member

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